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EDITED TRANSCRIPT

PBI - Q2 2014 Pitney Bowes Inc Earnings Call

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OVERVIEW:

PBI reported 2Q14 revenue of $958m, GAAP diluted EPS of $0.46, and GAAP EPS from continuing operations of $0.43. Expects 2014 revenue growth, excluding currency impacts, to be 1-3% vs. 2013 and GAAP diluted EPS from continuing operations to be $1.55-1.65.

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PRESENTATION

Operator

Good morning and welcome to the Pitney Bowes second-quarter 2014 results conference call.

(Operator Instructions)

Today's call is also being recorded. I would now like to introduce your speakers for today's conference call, Mr. Marc Lautenbach, President and Chief Executive Officer, Mr. Michael Monahan, Executive Vice President and Chief Financial Officer, and Mr. Charles McBride, Vice President Investor Relations. Mr. McBride will now begin the call with a Safe Harbor overview.

Charles McBride - *Pitney Bowes Inc - VP of IR*

Good morning. Included in this presentation are forward-looking statements about our expected future business and financial performance. Forward-looking statements involve risks and uncertainties that could cause actual results to be materially different from our projections. More information about these risks and uncertainties can be found in our 2013 Form 10-K annual report and other reports filed with the SEC that are located on our website at www.PB.com and by clicking on Investor Relations. Please keep in mind that we do not undertake any obligation to update any forward-looking statements as a result of new information or developments.

Also, for non-GAAP measures used in the press release or discussed in this presentation, you can find reconciliations to the appropriate GAAP measures in the tables attached to our press release and also on our Investor Relations website. Additionally, we have provided slides that summarize most of the points we will discuss during the call. These slides can also be found on our Investor Relations website. Now, our President and Chief Executive Officer, Marc Lautenbach, will start with a few opening remarks. Marc?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Good morning. And thank you for joining us. We are pleased with our second-quarter financial results which were in line with our long-term strategy for the business. Importantly, our second-quarter results contributed to a solid first-half performance that continued to substantiate both the strength of our long-term economic model and our long-term strategy.

Further, we remain ahead of schedule in our multiyear journey to transform our Company and unlock the inherent value of Pitney Bowes. As a result we're increasing our 2014 guidance for both revenue and adjusted earnings per share. Mike will give you more details on our guidance shortly.

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In terms of our second-quarter results, revenue, EBIT, adjusted EBIT margin, and adjusted EBITDA all grew year over year. Free cash flow for the quarter was strong at $162 million. All of these measures are important indicators of our performance in the quarter and first half of the year and position us nicely for a solid conclusion to the year.

You know from previous conference calls, meetings, and analyst days, I believe it is important to provide an update on our progress to transform Pitney Bowes against our three strategic initiatives. They are stabilizing our mail business, second, driving operational excellence, and finally, growing our digital commerce business.

Turning to the stabilization of the mail business. In the second quarter we saw a decline of 5% for the aggregate of our physical mail businesses, which includes our small and medium business, presort, and production mail businesses. The revenue performance of these three businesses was different than the last couple of quarters. However, it is what we expected for this quarter. Mike will update you on the performance in a moment, but there were two factors, both around timing.

The first was a couple of very large transactions in our production mail business last year. This contributed 3 of the 5 points of the aggregate revenue decline for the physical mail businesses. Secondly, based on the success of our new go-to-market model in SMB, we accelerated the implementation in North America. This caused a momentary disruption in our revenue performance early in the quarter, but by June we were back to a more normal trajectory.

The underlying fundamentals of our mailing business in aggregate continued to improve. Our go-to-market changes in SMB are producing results ahead of plan. And one of the most important signs of stabilization of our mail business is recurring revenue streams, and those declines continue to moderate on a year-to-year basis. We expect our mailing businesses to return to a pattern more consistent with the first quarter in the second half of the year.

Let me now discuss operational excellence. At Analyst Day back in May we provided additional insights and updates on our progress as we continue to focus on operational excellence. As we told you, our approach to operational excellence is not only to enhance our overall client experience, but also to drive efficiencies in our business overall. As I've commented before, operational excellence needs to show up in the income statement, free cash flow, and the balance sheet. And it has.

Our adjusted EBIT margin improved 110 basis points on a year-to-year basis, driven by reduced SG&A. Likewise, we drove very strong cash flow in the second quarter and first half. And over the last 18 months we have reduced inventory more than 40%, or $80 million. While we have made excellent progress improving our operational excellence initiatives, we have much more we will do.

Finally, our third strategic initiative is to grow our digital commerce businesses, which we continue to invest in. Once again, our digital commerce businesses which include e-commerce, shipping, software, and marketing services businesses delivered another outstanding top-line performance, growing revenue 27% in the second quarter.

Let me add that growing any business 27% is impressive. Growing a business of this scale at these rates is remarkable. License revenue in our software business grew double-digits, a strong indicator of the demand for our software products, which include location intelligence and customer engagement management software.

Our e-commerce business for cross-border shipping also continued to perform very, very well. Importantly, our pipeline from our digital commerce business is strong for the second half of the year. Mike will provide more color around our performance in each of these segments in his remarks.

Let me recap. We are transforming our business. In the first half of the year we've been able to grow revenue and profit, putting the Company on a very different trajectory while making investments in systems, marketing, software sales, and development. Moreover, we are methodically and surgically transforming the guts of our business through our ERP initiative. While I'm confident these initiatives in aggregate will drive substantial shareholder value over time, right now we are only scratching the surface.

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Again, we are pleased with our second-quarter performance and our first-half results. Our strategy is working and our unique value proposition among our clients is resonating and we continue to be excited about our prospects for the future. With that, let me now turn the call over to Mike.

Michael Monahan *- Pitney Bowes Inc - EVP & CFO*

Thank you, Marc, and good morning. As Marc indicated, we are pleased with our second-quarter results in light of the balanced mix of investment, efficiency, strategic change, and growth we achieved. Importantly, results in the quarter are consistent with the longer-term trends and the objectives we laid out for the Company at our Analyst Day. We expect continued improvement in the second half of the year. We believe we're on the right track to generate enhanced value for our shareholders, clients, and employees.

Going into the second quarter, we knew we had a challenging comparison for production mail against the prior year due to a couple of large deals in 2013. This impacted our consolidated revenue growth comparison by more than 2 percentage points alone this quarter. Additionally, as Marc noted, we accelerated the account shift in our North America mailing segment as part of our go-to-market channel strategy, which caused some temporary disruption in the sales process in April and May. However, results in June were back on trend.

Despite these two factors, year-over-year revenue grew on a reported basis and was flat on a constant currency basis. We continue to invest in our new ERP system and increased investments in sales, marketing, and account acquisition for our growth initiatives. Even with this incremental expense, we managed to reduce SG&A significantly, both in terms of dollars and as a percentage of revenue when compared to prior year. Adjusted EBIT dollars and margin both improved, driven in part by EBIT margin improvements in three segments.

Based on our year-to-date results and our outlook for the remainder of the year, we have increased our annual guidance for revenue and adjusted earnings per share from continuing operations. We have also narrowed the range for GAAP earnings per share from continuing operations. I'll provide more details on these updates after I take you through the results for the quarter.

Turning to our financial performance for the second quarter. Revenue totaled $958 million. Currency had less than a 1% negative impact on the results. Compared to the prior year, revenue grew 1% on a reported basis and was slightly positive on a constant currency basis.

On a reported basis, revenue in the digital commerce solutions segment grew 27% in the quarter. In the SMB solutions group revenue declined 3%. Revenue in the enterprise business solutions group declined 8%. Presort had solid growth but the production mail segment had the unfavorable prior-year compare as I noted.

Adjusted earnings per share from continuing operations were $0.46 for the second quarter, compared with $0.46 per share for the second quarter of 2013. However, you should note that prior year's adjusted EPS included $0.05 per share of non-recurring tax benefits. Taking the $0.05 tax benefit from last year into consideration, adjusted EPS this quarter grew 11% over prior year.

GAAP earnings per share from continuing operations were $0.43, which included restructuring charges of $0.03 per share associated with our previously announced cost reduction plans. GAAP earnings per diluted share for the second quarter were $0.46, which included income of $0.03 per share from discontinued operations.

Free cash flow during the quarter was a strong $162 million, and on a GAAP basis we generated $175 million in cash from operations. In comparison to the prior year, free cash flow benefited from the timing of tax payments and growth in bank reserve deposits. During the quarter, we used our cash to return $47 million to our shareholders in the form of dividends. We made $15 million in restructuring payments and paid down $100 million in debt.

Turning to the income statement. Please note that all income statement related results are on an adjusted basis. Adjusted earnings before interest and taxes, or adjusted EBIT, was $189 million this quarter, which was $12 million or 7% higher than the prior year. Adjusted EBIT margin was 19.7%, which was 110 basis points higher than the prior year. Adding back depreciation and amortization, adjusted EBITDA for the quarter was $238 million or $1.16 per share.

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SG&A for the quarter was $338 million, which was $16 million lower versus the prior year. As a percentage of revenue, SG&A was 35.3%, which was an improvement of 190 basis points over prior year. This was achieved despite the incremental expense related to the new ERP implementation. Excluding the ERP expense, SG&A would have been 34.9% of revenue.

During the quarter, we recorded a pretax restructuring charge of approximately $8 million for actions associated with our previously announced plans to reduce costs. Net interest expense, which includes financing interest was $42 million, which was a decline of $7 million when compared to the prior year. This is a result of actions we've taken to reduce our overall debt by $400 million over the past year, including the $100 million of bank term debt we paid down at the beginning of the quarter.

Average outstanding borrowings during the quarter were about $765 million lower than the prior year. The average interest rate this quarter was 5.27%, which was 18 basis points higher than the prior year.

The effective tax rate on adjusted earnings for the quarter was 33.4%, compared to 23.6% in the second quarter last year. The prior year included favorable resolution of tax issues globally. The current quarter's tax rate is higher than the rate we might expect for the full year as a result of the business mix in the quarter. However, the year-to-date tax rate of 30.8% is within our expected range of 29% to 31%.

Looking at the balance sheet, we had $3.2 billion of debt on the balance sheet at the end of the quarter, which was $414 million less than the second quarter of last year. As I mentioned earlier, in April we reduced bank term loans by $100 million. These loans were scheduled to mature in 2016.

Now I'd like to discuss the second-quarter results for each of our business segments. This information can also be found in our earnings press release and the slides that we posted to the www.PB.com website under the Investor Relations section.

In North America mailing, revenue for the quarter was $371 million, and EBIT was $157 million. Revenue declined 5% on a reported and constant currency basis when compared to the prior year. As mentioned earlier, we accelerated the implementation of our SMB go-to-market strategy. While this resulted in lower equipment sales revenue in the quarter, we saw improved trends in the month of June and expect improving equipment sales in the second half of the year.

Recurring revenue streams declined at a lesser rate than prior year, supporting our long-term stabilization objective, and benefited again from growth in supplies revenue. EBIT margin was 42.2%, an improvement of a full 200 basis points versus the prior year as a result of our overall operational initiatives, including the improved selling cost ratio and lower marketing spend.

In international mailing, revenue for the quarter was $153 million, and EBIT was $26 million. Revenue grew 2% on a reported basis and declined 2% on a constant currency basis when compared to prior year. The modest constant currency decline in revenue resulted from lower equipment sales in Europe. However, as a result of stabilizing the installed equipment base in recent periods, the segment continues to experience an improvement in the year-over-year trend in its recurring revenue streams.

EBIT margin was 17.3%, which was an improvement of 390 basis points versus the prior year. The improvement in EBIT margin was due to various cost reduction initiatives, including the initial implementation of the go-to-market model in our priority European markets.

Turning to the enterprise business solutions group. In production mail, revenue for the quarter was $112 million and EBIT was $11 million. Revenue declined 17% on a reported basis and 18% on a constant currency basis when compared to prior year.

As we noted, the production mail revenue comparison for this quarter reflected the impact of two deals comprised of several large inserting and production print equipment installations in the second quarter of the prior year. While this comparison impact is principally reflected in the equipment sales line, recurring revenue in the current quarter continued to improve, benefiting from growth in supplies related to the growing production print installed base.

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EBIT margin was 9.4%, which was a decline of 230 basis points versus the prior year due to the lower revenue and related margin contribution. In presort services, revenue for the quarter was $111 million and EBIT was $22 million. Revenue grew a very solid 4% on both a reported and constant currency basis when compared to the prior year. Revenue benefited from further improved qualifications of mail for presort discounts as a result of operational enhancements and the effective implementation of the postal rate change at the beginning of the year.

EBIT margin was 20.1%, which was a an increase of 20 basis points over prior year due to lower facility costs and improved operational productivity. For the digital commerce solutions segment, revenues was $211 million and EBIT was $18 million. Digital commerce solutions was 22% of consolidated revenue in the quarter, up from 15% when we first introduced this segment at our May 2013 Analyst Day. This reflects the substantial organic growth in the portfolio.

This organic growth continued in the second quarter as revenue grew 27% on a reported basis and 26% on a constant currency basis when compared to the prior year. This revenue growth was driven primarily by the continued strong demand for our e-commerce solutions for cross-border package delivery.

Revenue also benefited from improved growth in the other major elements of the digital commerce solutions segment, including software, shipping solutions, and marketing services. In particular, software revenue, which was up 9% on a reported basis, benefited from a double-digit increase in license sales including client wins in the business applications vertical market.

EBIT margin was 8.5%, which was a decline of 70 basis points versus the prior year. EBIT and EBIT margin reflect the benefit of revenue growth that was partially offset by our continued investment in e-commerce technology and infrastructure. EBIT margin was also impacted by the ongoing investment in the software channel specialization and overall increased research and development spend. That concludes my comments on our financial performance this quarter.

Now I'd like to update you on our 2014 guidance. Based on our year-to-date results and the outlook for the remainder of the year, we are increasing our annual guidance for revenue and adjusted EPS from continuing operations. We are also narrowing the range of our guidance for GAAP EPS from continuing operations. Our annual free cash flow guidance remains unchanged.

2014 revenue growth excluding the impacts of currency is now expected to be in the range of 1% to 3% growth when compared to 2013. This updated revenue guidance reflects the expected ongoing stabilization of our mail related businesses and continued growth in digital commerce solutions.

Adjusted earnings per diluted share is now expected to be in the range of $1.80 to $1.90, which reflects our operational performance year to date, the increased revenue outlook, and the timing of investment in solutions and infrastructure such as ERP.

I'd like to reiterate as we outlined in our original guidance, we expect to spend approximately $30 million or $0.10 per share on a new ERP system this year. To date, the ERP spend has had about a $0.03 per share impact on EPS as we started the process of identifying the right platform, requirements, and resources. We expect this expense to ramp up in the second half of the year, as will our investments in our growth initiatives. We now expect GAAP earnings per diluted share from continuing operations to be in the range of $1.55 to $1.65, which reflects our year-to-date charges for restructuring costs of $0.06 per share and $0.19 per share for debt extinguishment costs in the first quarter.

Finally, our free cash flow guidance remains unchanged and is expected to be in the range of $475 million to $575 million. Our guidance includes any further actions that are under consideration to streamline our operations and further reduce our cost structure. That concludes my remarks. Operator, you may now open the line for questions.

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QUESTIONS AND ANSWERS

Operator

Thank you very much. (Operator Instructions)

Our first question will come from Kartik Mehta with Northcoast Research. Please go ahead.

Kartik Mehta - *Northcoast Research - Analyst*

Good morning. Just a couple questions on the digital commerce business. Marc, how much of that growth is eBay and how much is it is just your ability to expand beyond that and that business segment just starting to take hold for Pitney?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I think it was all of the above. As you know, we don't break out particular revenue with clients. As I commented, our e-commerce business continued to perform very well. We're pleased with that.

As Mike indicated, and I indicated as well, however, it was balanced across the portfolio. Licensed revenue growing double-digits, marketing services growing, good performance in shipping. So I would say the performance across digital commerce was balanced. Certainly e-commerce has been a strong engine. We expect it will continue to be a strong engine.

I would reiterate what I said. We kind of take for granted this business now which is $211 million a quarter but growing north of 20% for a couple quarters. We now have a pretty big business that's scaling at pretty remarkable rates. I'm very pleased with that performance.

Kartik Mehta - *Northcoast Research - Analyst*

Marc, as you look at your software business, it's been kind of stuck in that $400 million range for a little while now. Do you finally feel that you're in a position to be able to break that? I know you've made some changes and are those -- do you feel comfortable that those changes will result in that business finally achieving the kind of growth that you would expect?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

If I just said yes, would that be enough?

Kartik Mehta - *Northcoast Research - Analyst*

Probably.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

Listen, no, I think the -- to answer the question, we're very confident in the changes that we made will have the right effects. You're starting to see chutes of it now. We're acquiring some new clients. You're starting to see the impacts of specialization.

It's not as pervasive yet, as across the board as it will be in 12 months, but there's enough early signs and I can't believe I've got enough experience here to know that having a specialized sales force is a pretty sure bet in terms of driving the kind of growth. That said, we're still early days in that.

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Kartik Mehta - *Northcoast Research - Analyst*

And then just one last question. Where your balance sheet sits and where your debt levels are, is this the level where you would like to keep it or is the thought that you'd like to continue to lower the debt from here?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of the balance sheet, I think as you've seen, we're in very solid shape. I think what I would say about the balance sheet is we have flexibility in terms of balancing both investment in the business as well as continuing to look at debt management. We look at it carefully. We do have a number of investments that we're making in the business on an organic basis, but the bottom line is I think it gives us flexibility in what we need to do around the balance sheet.

Kartik Mehta - *Northcoast Research - Analyst*

Thanks, Mike. Appreciate it.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Thank you.

Operator

Thank you. Our next question in queue will come from Ananda Baruah with Brean Capital. Please go ahead.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Thanks, guys, for taking the question and congratulations on a solid quarter. Just a few from me, if I could. I guess the first is with regards to the comments for the core mailing business. When you say that second half of the year should resemble March quarter, should we interpret that as meaning low single-digit declines, do you expect to go back to down 2% kind of area?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I don't think the conversation requires a lot of interpretation. Second half of the year looks more like the first quarter. I think that's kind of how we would characterize it. I'm not going to give you a specific number. But that's I think a fair characterization of how we see it right now.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Okay. Great. And then you mentioned the investment you're doing in digital commerce and the impact that it had on the margins this quarter. I guess what should be our expectation anecdotally for how the margins sort of manifest through the balance of the year? They were down on a year-to-year basis this quarter. And they've been increasing nicely kind of prior to that. So just any context there would be useful.

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Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of context, obviously there's different ways that we invest in the business. So I think what you've seen is some improvement in the gross margin, which is representative of the scaling business. But then the decision to reinvest both in infrastructure as we broaden the base of customers, building out channel capacity, the infrastructure associated with the growing volume of the business.

And so it's a combination of those things, but obviously the aggregate of digital commerce includes both the e-commerce investment as well as the investments we're making in the software business around the channel. So as the business scales over time we would expect to see that come through in margin improvement.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it. That makes sense. And should we view the balance of this year as being sort of falling more on the investment side, sort of not yet -- should we expect to see -- I guess you're going to be investing for the balance of this year. Do you think you can expand margins for the balance of this year or should we not have that expectation?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I think your latter comment is the right one. We said explicitly we plan to invest in the second half of the year. How that impacts margin will really be a factor of how we see the revenue come through.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

A little context here is probably helpful. We were very clear 15 months ago that our strategic intent in digital commerce business for the near to medium term was to grow. We see $28 billion of opportunity there. We're growing nicely. $200 million a quarter is nice, but we're still early stages in these markets.

So our strategic intent is to get real strength in these markets over the next several years and that's where our focus is. I want to take advantage of what I think are some great capabilities to build a great franchise. These businesses intrinsically have good margin performances. But as you're building them, you realize a slightly different profile.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Got it. Thanks, Marc. Just last one from me. With regards to the software, the license growth comments in software, were they across the software portfolio, location intelligence, data quality, et cetera, or are they more focused in particular areas?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of that, I'd say it was obviously across the portfolio. We did have some good wins in location intelligence in particular.

Ananda Baruah - *Brean Capital, LLC - Analyst*

Great. Thanks a lot, guys.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Thank you.

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Operator

Thank you. Our next question will come from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross - *Cross Research - Analyst*

Thank you very much. Good morning. My first question is with regard to the North American mailing and then how we think about some of the restructuring you're going to be doing in Europe. Obviously there was a bit of a hiccup earlier in the quarter in terms of the changeover in sales force. Can you talk a little bit more about what happened there, what you've now seen in July, and then how we should think about some of the changes in sales force that you're going to be making in Europe I guess in the coming quarters.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Yes Shannon, I would say it was less of a hiccup and more of a planned acceleration of the implementation of our go-to-market, which means we're moving from a heavier load of direct selling to more web and inside sales. And naturally, when you go through that transition, there will be some impact.

Because of the success we've had over the last year or so in that implementation, we actually decided to accelerate and really essentially complete the North American effort. As we've begun in Europe, as we noted, we obviously have the benefit of the learnings from the North American implementation.

To Marc's earlier point, this is a long-term transformation of the business and we will expect that there will be little differences quarter to quarter here and there. The important thing is that after two months of implementation, because we implemented on April 1, we're essentially back on track. Which I think lines up well with what we saw in the earlier phases, but on a smaller scale.

Shannon Cross - *Cross Research - Analyst*

Okay. And just to confirm, July has continued the same kind of trend line that you saw in June?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Well, I'm not going to get into month to month, but obviously our annual guidance reflects our confidence around the business as a whole.

Shannon Cross - *Cross Research - Analyst*

We got to try, right? Okay.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Never knock you for trying.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

July hasn't even ended yet.

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Shannon Cross - *Cross Research - Analyst*

And then on the digital commerce business, I'm just curious, Marc, as you look to the growth going forward for digital commerce or for e-commerce especially, how much is required to sort of expand in additional partners and that relative to the sort of focus on eBay at this point? I know you do have some other smaller ones.

And versus what are you hearing from eBay in the terms of what they are seeing from their sellers and their willingness to adopt international sales and their willingness to go out and sort of evangelize the opportunity?

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

I'm not going to comment for eBay. They're more than capable of commenting for themselves. Nor am I going to talk about specific relationships. I will say our first focus has been and always will be to take care of the clients that we have. We see that as a primary responsibility.

That said, there's a lot of demand for this stuff and these capabilities. You see it in some of the others in the industry and parcels, and then the confluence of parcels and global together is an incredibly exciting combination.

This marketplace as we pointed out in May is roughly $6 billion or $7 billion. We've got a business here that's growing nicely but we got a ton of head room. So my expectation is that we'll take great care of the clients that we have and in a reasonable term we'll continue to add clients.

Shannon Cross - *Cross Research - Analyst*

Okay. And then just finally, in terms of use of cash from an acquisition standpoint it seems like you're pretty comfortable with the assets you have. What are your thoughts on share repurchase and that now that the balance sheet is in really good shape?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

As I mentioned earlier, I think what the condition of the balance sheet today really provides us is flexibility. So it's another arrow in the quiver, so to speak. We will look at it opportunistically as we've talked in the past, but right now the good news is we have plenty of opportunities to invest in the business organically as well as to look at how we might add to that capability.

Shannon Cross - *Cross Research - Analyst*

I guess the question is how often do you sort of review it? Because it's been -- you've had the arrow in the quiver for a while in terms of your commentary, so I'm just curious, are we getting closer to sort of that or do you still think that the organic investments and opportunity are going to outweigh it for the foreseeable future?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I think we have the option, right. That's the important thing. So we always look at the various tools we have available to us. We look at it on a regular basis. But we'll use it when we think it's most appropriate to use it.

Shannon Cross - *Cross Research - Analyst*

Okay. Thank you.

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Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Thank you.

Operator

Thank you. (Operator Instructions)

And next in queue is George Tong with Piper Jaffray. Please go ahead.

George Tong - *Piper Jaffray - Analyst*

Good morning. Thanks for taking my questions. I wanted to revisit your performance in the e-commerce segment, particularly around the eBay partnership. Can you give us some insights perhaps qualitative into the magnitude of the e-commerce from the step-up, and how many countries you're currently serving in the eBay partnership?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

In terms of outbound countries, address the last part first, we now ship outbound to 55 countries around the world. So that's for any of our e-commerce customers. So that's something that we've continued to expand and grow and will continue to grow.

To the earlier question about this business, we are a US outbound business today. We have opportunities to go outbound to more markets as well as we have the opportunity to be outbound from other markets around the world. So there's a lot of opportunity for growth. E-commerce was obviously a meaningful driver in the digital commerce portfolio and that shows up in our business services growth.

George Tong - *Piper Jaffray - Analyst*

Got it. You've previously provided e-commerce revenue targets of about $200 million to $300 million over the next two to three years. Is that still sort of your goal going forward?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I think the way that hat particular comment was phrased was around some early-stage growth initiatives. I would say that e-commerce has proven to be very successful relative to that estimate because I think it was a three to five year estimate. So we feel very good about where we're positioned for e-commerce over the future.

George Tong - *Piper Jaffray - Analyst*

And then just turning to profits, your current operating margins in digital commerce and specifically e-commerce are likely lower now than where they structurally can be due to your near-term investments. Can you just provide some additional color on the investments you're making and when you expect to see margin expansion in the segment.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

You're talking specifically to the digital commerce segment?

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George Tong - *Piper Jaffray - Analyst*

Really focused on e-commerce.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

On e-commerce. Yes, I think that the question will be how much opportunity do we have and where over time. So I would expect clearly we'll continue to make investments both as I say in expanding our current base of business as well as expanding the markets that we can serve.

So clearly as the business scales, there will be first contribution on a gross margin line and then leverage as we get bigger, and that will -- the relative level of investment will really be against what we see as the growth opportunity in the business.

George Tong - *Piper Jaffray - Analyst*

And would you say your investments in e-commerce are targeted more along the lines of sortation capacity or would you say they're targeted more along the lines of sales and marketing.

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

I would say there's three things. There's the infrastructure to support the physical movement of the goods. There's the investment in the technology where we believe we have some significant competitive advantage. And the third piece is as you described, which is expanding our channel and support infrastructure.

George Tong - *Piper Jaffray - Analyst*

Got it. That's helpful. And then just going back to your core business, could you provide some additional details around what recurring revenue trends were in North America internationally specifically, whether we're close to breakeven and how much of a deceleration and decline we're seeing?

Michael Monahan - *Pitney Bowes Inc - EVP & CFO*

Obviously, you can see the individual line items on the P&L in aggregate, and we don't tend to break those out individually. But in both North America and international, we did see improvement in the recurring revenue streams on a year-over-year basis, comparing second quarter to second quarter.

Particularly good was in the supplies area where we saw, again, continued growth in both of those places. And we saw in particular some improvement in financing revenue in the international space, where as we've stabilized that base over time, it's manifested itself in improved outlook relative to financing revenue.

George Tong - *Piper Jaffray - Analyst*

That's very helpful. And then I guess lastly, with your balance sheet now sort of where you'd like it to be, your cash flow usage is now much more flexible, which opens the door to M&A. Can you just sort of talk about what kind of M&A opportunities you're focused on and where you'd like to focus and direct your spend in terms of inorganic growth?

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Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

George, I'd go back to what we said. In the main we have the assets that we think we need. We've got an addressable market in our growth businesses of $28 billion. So as you look at the intersection of those two points, what it leads you is the kinds of acquisitions that we would be more inclined to do would be around adding capabilities, and they would tend to be make versus buy types of decisions, either we can develop it ourselves or we can partner with others.

So while I wouldn't rule out something broader than that, I think in the main that's what we're going to be looking for. As you know, we put out pretty disciplined financial criteria that any acquisition would have to make and we continue to think those parameters for decision making are correct. So it's got to be accretive in a fairly short amount of time. It's got to be cash flow positive in five years. It's got to be strategically coherent. It's got to have the right IRR. So I would say beyond the intersection of those broad principles, what you would expect is it will be very disciplined.

George Tong - *Piper Jaffray - Analyst*

Got it. Thank you.

Operator

Thank you. At this time there's no additional questions in queue. Please continue.

Marc Lautenbach - *Pitney Bowes Inc - President & CEO*

So let me close. From my perspective, and I think a fair judgment is our transformation is ahead of any schedule I would have envisioned, our first-half results and our improved guidance I think clearly demonstrate the point, and on balance we are very pleased with where we are.

That said, the most compelling evidence for our transformation I see are our client relationships, the 1.5 million small-medium business clients that we do business with every day, some of the largest e-commerce, social media, and business platform companies in the world. And what we hear, what I hear from these clients over and over again is our products are relevant and our strategies are on target.

So the way I net that out is I'm more confident than ever in our future and our way forward. So I very much appreciate everyone's interest in the Company and we continue to work to improve our business. We'll talk to you again in 90 days. Thank you.

Operator

Thank you. Ladies and gentlemen, this conference will be available for replay after 10:00 AM Eastern Time today running through August 31 at midnight. You may access the AT&T Executive Playback service at any time by dialing 320-365-3844, using the access code of 330301. Once again that phone numbers is 320-365-3844, using the access code of 330301.

That does conclude your conference call for today. We do thank you for your participation and for using AT&T's Executive Teleconference. You may now disconnect.

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